

ORIGINAL

LAW OFFICES  
2101 L Street NW • Washington, DC 20037-1526  
Tel (202) 785-9700 • Fax (202) 887-0689

EX PARTE OR LATE FILED

Writer's Direct Dial: (202) 828-2236  
A5691.0542

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April 18, 2002

APR 18 2002

Federal Communication Commission  
~~General Office~~ Secretary

Marlene H. Dortch, Secretary  
Federal Communications Commission  
The Portals  
445 12<sup>th</sup> Street, S.W., TW-A325  
Washington, DC 20554

**NOTICE OF ORAL EX PARTE  
COMMUNICATION**

**Re: Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128; Colorado Payphone Association Petition for Reconsideration re Retroactive Adjustment of Second Report and Order Period Compensation; Retroactive Adjustment of Interim Compensation**

Dear Ms. Dortch:

On April 17, 2002, Albert H. Kramer and Robert F. Aldrich, attorneys for the American Public Communications Council ("APCC"), had a meeting with Associate General Counsel Linda Kinney and Joel Marcus of the Office of the General Counsel. The matters discussed are detailed in the enclosed documents, copies of which were handed out at the meeting.

Sincerely,



Robert F. Aldrich

Enclosures

cc: Linda Kinney  
Joel Marcus

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List ABCDE

1177 Avenue of the Americas • 41st Floor • New York, New York 10036-2714  
Tel (212) 835-1400 • Fax (212) 997-9880

# **PAYPHONE COMPENSATION REFUND ISSUES**

**AMERICAN PUBLIC COMMUNICATIONS COUNCIL**

**APRIL 2002**

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## RETROACTIVE COMPENSATION ADJUSTMENTS

Ex Parte Presentation  
CC Docket No. 96-128  
American Public Communications Council

### I. THE COMMISSION MUST ADDRESS THE EQUITY BALANCING ISSUE RAISED BY COLORADO PAYPHONE ASSOCIATION

- ◆ In the *Third Payphone Order*, the Commission set a new dial-around compensation rate of \$.238 per call, after the court of appeals remanded the previously established rate of \$.284 per call.
- ◆ In that order, the Commission summarily decided that payphone service providers ("PSPs") must refund the difference between the \$.238 and the \$.284 rate for all compensation received during the Intermediate Period (October 7, 1997 – April 21, 1999) when the \$.284 rate applied. The refunds are to be paid simultaneously with the planned true-up of Interim Period (November 7, 1996 – October 6, 1997) compensation payments.
- ◆ The Commission ordered refunds without considering the equities of ordering refunds, as numerous court decisions require. The Colorado Payphone Association's April 21, 1999 petition for reconsideration requests the Commission to reconsider and determine that the equities do not warrant requiring independent PSPs to pay refunds. The FCC has yet to decide this petition.

### II. RETROACTIVE REFUNDS ARE NOT AUTOMATIC: THEY ARE TO BE ORDERED ONLY IF THE EQUITIES SO REQUIRE.

- ◆ The standard for granting refunds after a remand is the equitable standard of "unjust enrichment." *Atlantic Coast Line R.R. v. Florida*, 295 U.S. 301 (1935); *Public Service Commission of West Virginia v. Economic Regulatory Administration*, 777 F.2d 31, 35 (D.C. Cir. 1985); *Las Cruces TV Cable v. FCC*, 645 F.2d 1041, 1047 (D.C. Cir. 1981); *Moss v. Civil Aeronautics Board*, 521 F. 2d 298 (D.C. Cir. 1975). The decision on retroactivity must be "equitable in the circumstances," *Wisconsin Electric Power Co. v. FERC*, 602 F.2d 452, 457 (D.C. Cir. 1979).

- ◆ In remanding the FCC's Intermediate Period rate of \$.284, the court of appeals recognized the equitable standard, approving the Commission's position that it "may" order refunds "if the equities so dictate." *MCI Telecommunications Corp. v. FCC*, 143 F.3d 606, 609 (D.C. Cir. 1998).

### III. THE EQUITIES DO NOT SUPPORT RETROACTIVE APPLICATION OF THE \$.24 (\$.238) RATE TO INDEPENDENT PSPS

#### A. Independent PSPs Were Not Unjustly Enriched

- ◆ Independent PSPs Suffered Massive Undercompensation During the Early Period
  - The FCC erroneously determined that it lacked statutory authority to prescribe compensation for subscriber 800 calls during the period 1992-96.
  - For more than four years immediately prior to the compensation periods under review, interexchange carriers ("IXCs") paid no compensation to independent PSPs for subscriber 800 calls.
  - APCC submissions provide a basis for quantifying the Early Period underpayment suffered by independent PSPs.
  - Using a conservative approach to estimating underpayments, APCC has determined that its independent PSPs clients were undercompensated in the Early Period by \$82 million, while the refund, if any, that they would owe for the Intermediate Period is about \$33 million.
- ◆ Independent PSPs' actual compensation in the Intermediate Period was far below the minimum level established by the Commission in the Third Report and Order
  - The FCC set the current \$.238 per call rate to ensure that a *marginal* payphone, with 142 dial-around calls per payphone per month, would recover \$33.80 of the fixed monthly costs of operating a payphone (\$.238/call x 142 calls = \$.33.80).
  - Independent PSPs actually received compensation payments for only 109 calls per payphone per month at *average* payphones. They only received compensation

for about 97 calls per payphone per month at *marginal* payphones. At the Intermediate Period rate of \$.284 per call, this is \$27.55 per payphone per month -- \$6.25 short of the \$33.80 contemplated by the *Third Report and Order*.

- ◆ Retroactively applying the \$.238 rate would exacerbate the undercompensation of independent PSPs
  - If the Commission requires independent PSPs to refund the difference between \$.238 and the \$.284 collected in the Intermediate Period, marginal payphone compensation payments would be reduced to \$23.09 per payphone per month -- \$10.71 short of the \$33.80 contemplated by the *Third Report and Order*.
  - To ensure the amount of cost recovery intended by the *Third Report and Order*, adjusted compensation for the Intermediate Period would have to be set at \$.348 per call ( $\$33.80/97 = \$.348$ ).

**B. Refunds would provide a windfall to IXC**

- ◆ IXCs already recovered their compensation payments to PSPs -- through payphone surcharges, rate increases, and payphone related cost savings on access charges and 0+ commissions.
- ◆ IXCs would not pass their refunds on to end users.
- ◆ There is no way to refund Intermediate Period compensation to the original end users from whom it was recovered.

**IV. OTHER FACTORS DO NOT SUPPORT REFUNDS**

- ◆ Payphone traffic volume and payphone deployment has declined sharply due to wireless services and other factors.
- ◆ A refund of \$33 million equals a full quarter's dial-around compensation for APCC's independent PSP clients. A refund will further disrupt an already reeling independent payphone industry.
- ◆ The true-up process will cause an administrative nightmare for independent PSPs in light of the upheavals in the industry since 1997.

- ◆ In a true-up, IXC's will unilaterally determine which PSP is responsible for a refund, and in what amount, for which payphones, and will simply deduct the amount from the PSPs' current dial-around compensation. PSPs must litigate to correct errors in such unilaterally collected refunds.

**V. INDEPENDENT PSPS ARE DIFFERENTLY SITUATED FROM ILEC-AFFILIATED PSPS**

- ◆ ILECs were not undercompensated during the 1992-96 period.
- ◆ Most ILECs did not experience the same call tracking problems as independent PSPs in the Intermediate Period, because most lines connected to ILEC payphones did not require FLEX ANI in order to transmit payphone call identifiers to IXCs.
- ◆ ILECs continued to recover their payphone costs through access charge and local exchange subsidies during the first five months of the Interim Period.
- ◆ Retroactive application of the \$.238 rate would bring the prior-period compensation of ILECs closer to cost recovery levels, but would aggravate the cost recovery shortfall already experienced by independent PSPs.

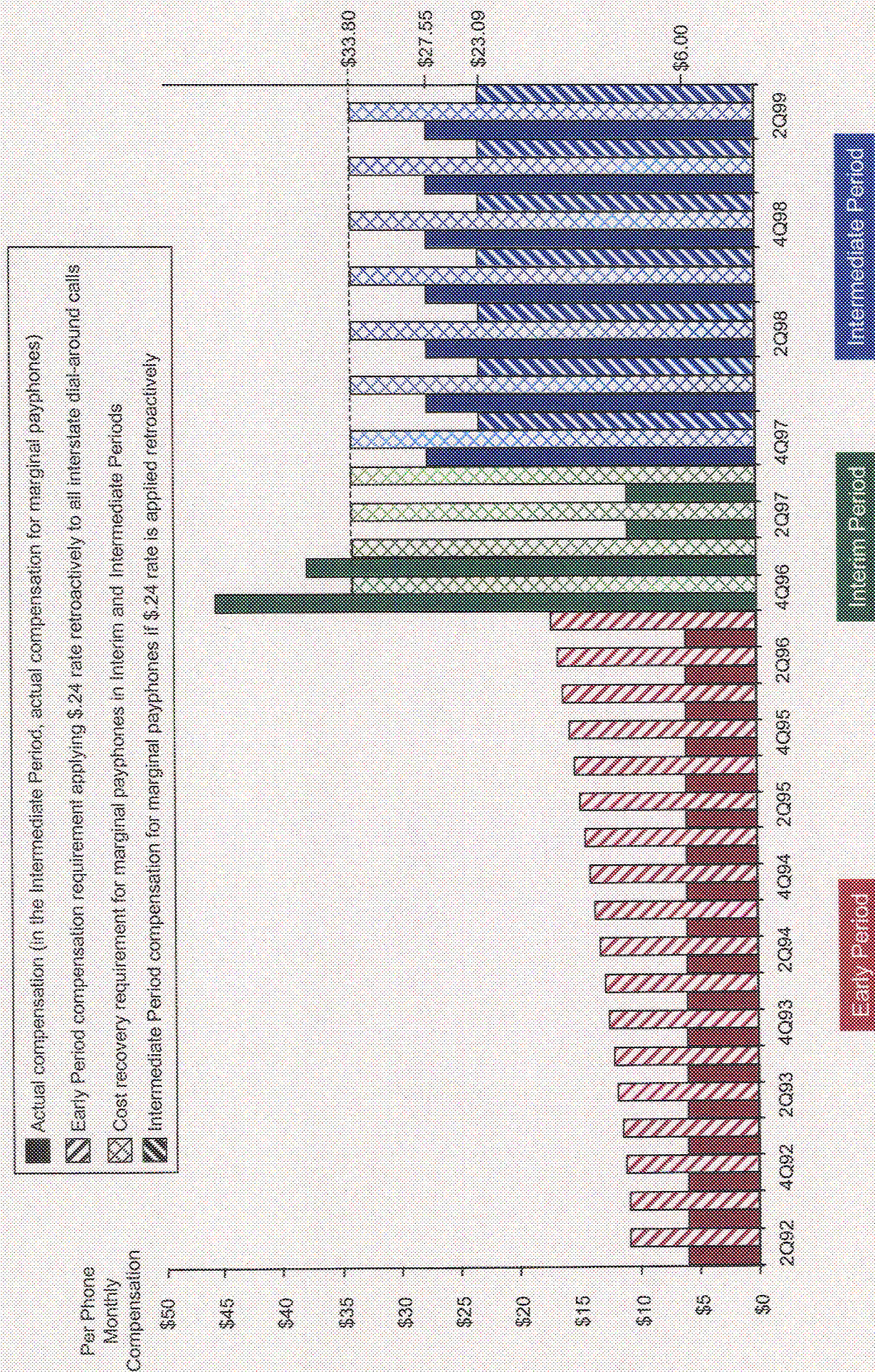
**VI. NO REFUND IS WARRANTED FOR INDEPENDENT PSPS**

- ◆ The Commission should reconsider its refund order and declare that no refund for the Intermediate Period will be required from independent PSPs.
- ◆ The Commission could also declare a "wash" as between independent PSPs and IXCs.





# Independent PSP Compensation 1992-1999







L A W   O F F I C E S

2101 L Street NW • Washington, DC 20037-1526  
Tel (202) 785-9700 • Fax (202) 887-0689

Writer's Direct Dial: (202) 828-2236  
A5691.0542

April 15, 2002

William F. Caton, Acting Secretary  
Federal Communications Commission  
The Portals  
445 12<sup>th</sup> Street, S.W., TW-A325  
Washington, D.C. 20554

**Re:   Standards for granting Retroactive True Ups: Implementation of the  
Pay Telephone Reclassification and Compensation Provisions of the  
Telecommunications Act of 1996, CC Docket No. 96-128; Colorado  
Payphone Association Petition for Reconsideration re Retroactive  
Adjustment of Intermediate Period Compensation; Retroactive  
Adjustment of Interim Compensation**

Dear Mr. Caton:

The American Public Communications Council ("APCC") submits the following legal analysis showing that equitable considerations preclude any retroactive refund of compensation payments collected by independent payphone service providers. ("PSPs") from interexchange carriers ("IXCs") during the period from October 7, 1997 to April 21, 1999 ("Intermediate Period").<sup>1</sup>

**SUMMARY**

As recognized by the D.C. Circuit in *MCI Telecommunications Corp. v. FCC*, 143 F.3d 606 (D.C. Cir. 1998) (which gave rise to the Intermediate Period refund issue by remanding the Commission's \$.284 compensation rate), the question whether to order retroactive rate adjustments after a court remand is a question of equity. There is no presumption that a true-up must be held after a court remand.

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<sup>1</sup>     The question whether to order retroactive refunds for the Intermediate Period is before the Commission in the Colorado Payphone Association's April 21, 1999, petition for reconsideration ("*CPA Petition*") of the *Third Payphone Order. Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, *Third Report and Order and Order on Reconsideration of the Second Report and Order*, 14 FCC Rcd 2545 (1999) ("*Third Payphone Order*") *aff'd*, *American Pub. Com. Council v. FCC*, 215 F.3d 51 (D.C. Cir. 2000).

The Commission *may* order a refund and true-up of compensation payments only if the Commission finds, after balancing the equities, that such retroactive payments and refunds are warranted in the circumstances of this proceeding.

When the standards of equity established by precedent are applied to the circumstances of this case, it is clear that no true-up is warranted, much less required, between independent PSPs and IXC's. First, and of greatest importance, the "unjust enrichment" standard for granting post-remand refunds has not been satisfied. The independent PSPs have earned no excessive profits. In fact, the compensation actually collected by independent PSPs has failed to meet the FCC's own cost-based standard of fair compensation both in the Intermediate Period and in every other compensation period from 1992 through 1999.

Indeed, even if the Commission could possibly find that independent PSPs had gained excessive profits in the Intermediate Period, (and as mentioned above and we demonstrate below, there actually has been a cost recovery shortfall) the Commission must determine whether a refund of Intermediate Period compensation collected by independent PSPs is "equitable in the circumstances" (*Wisconsin Electric Power Co. v. FERC*, 602 F.2d 452, 457 (D.C. Cir. 1979)). In doing so, the Commission must recognize that the relevant circumstances here extend beyond the boundaries of the Intermediate Period. The relevant circumstances include a series of legal errors committed by the Commission in three sequential periods – the Early Period (June 1, 1992 – November 6, 1996), the Interim Period (November 7, 1996 – October 6, 1997), and the Intermediate Period. When all three periods are considered together, it is clear that compensation that PSPs lost due to the FCC's legal errors, and the attendant enrichment of IXC's, both on an individual and collective basis, far outweighs any excess compensation that PSPs could possibly be found to have collected during the Intermediate Period.

By contrast, to award a retroactive refund for the Intermediate Period would provide a windfall for IXC's who have already recovered – and overrecovered – the full amount of the compensation paid to PSPs during that period. A retroactive refund would therefore accord IXC's triple recovery – recovery from end users, who would not get back any of the payphone surcharges they paid, the "free ride" the IXC's experienced by avoiding payment for the majority of dial around calls for a 4 year period,<sup>2</sup> and recovery from PSPs pursuant to the retroactive refund.

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<sup>2</sup> See Letter of April 15, 2002 to William F. Caton, Acting Secretary, FCC, from Albert H. Kramer and Robert F. Aldrich re Early Period (1992-1996) Compensation ("Early Period Ex Parte").

Additionally, a refund of the size contemplated would endanger the economic health of the payphone industry, would create an administrative nightmare for the payphone industry, and would unfairly penalize PSPs even further by forcing them to bear the burden of correcting all errors.

**I. REFUNDS OF PAYPHONE COMPENSATION MAY NOT BE AWARDED IF THERE WAS NO UNJUST ENRICHMENT OF PAYPHONE SERVICE PROVIDERS**

The refund issue for the Intermediate Period arises from *MCI*, 143 F.3d 606, which remanded (without vacating) the Commission's \$.284 rate. That decision expressly recognized that refunds are a form of equitable relief reserved for circumstances where a refund is required to do equity between the parties. Thus, the court, quoting the Commission's own finding, stated that the Commission "may" order refunds "if the equities so dictate." *MCI* at 609, quoting *Pleading Cycle Established for Comment on Remand Issues in the Payphone Proceeding*, FCC 97-1673 (Aug. 5, 1997). The court plainly did not require the Commission to order a refund in the event that the Commission, on remand, established a rate of less than \$.284. The court did not even create a presumption of a refund.

The court of appeals' use of "may" rather than "shall" was no accident. In *Consumer Federation of America v. Federal Power Commission*, 515 F.2d 347 (D.C. Cir. 1975), *cert. denied*, 423 U.S. 906 (1975), the court of appeals, in reversing a Federal Power Commission rate order on the merits,<sup>3</sup> stated:

We express no opinion on the refund issue, beyond saying that, in our view, it involves complex and difficult questions which must be presented to and addressed by the Commission in the first instance. In matters of prospective and retroactive effect, there are large questions of equity and public interest – both for agencies and for courts . . . . Whether and how to exercise an authority to order refunds requires the development of factual matters not presently in the record as well as a broad and penetrating analysis of "the factors pro and con a refund,

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<sup>3</sup> In an earlier phase of the proceeding, the Supreme Court had vacated a stay, granted by the Court of Appeals, of the Federal Power Commission ("FPC") rate order under review. In overturning the stay, the Supreme Court had relied on a similar representation by the Solicitor General that the FPC "would have full authority to require refunds of any [excessive] rates collected by a natural gas company." *Id.* at 359.

and its amount or extent, in arriving at an equitable conclusion.”

*Id.* at 359, quoting *Public Service Commission of the State of New York v. Federal Power Commission*, 329 F.2d 242, (D.C. Cir. 1964), *cert. denied*, 377 U.S. 963 (1964). The MCI court followed these precedents and similarly refrained from tying the FCC’s hands in advance of a “broad and penetrating analysis of ‘the factors pro and con a refund’” in this proceeding. Such an analysis, however, must be completed before deciding whether to award refunds.

In general, the standard governing agency decisions to award rate refunds is an equitable one, in which the agency must strike a “balance . . . between the comparative benefits and losses, often termed ‘equitable considerations.’” *Las Cruces TV Cable v. FCC*, 645 F.2d 1041, 1047 (D.C. Cir. 1981), quoting *Public Service Commission v. FPC*, 329 F.2d 242, 250 (D.C. Cir.), *cert. denied*, 377 U.S. 963 (1964). See also *Wisconsin Electric Power*, 602 F.2d at 457 (refund decision must be “equitable in the circumstances”); *Koch Gateway Pipeline Co. v. FERC*, 136 F.3d 810, 817 (D.C. Cir. 1998) (holding that a refund must be equitable under the circumstances). Applying this standard, reviewing courts have recognized in numerous cases that the particular circumstances involved do not justify the grant of refunds.<sup>4</sup>

Unless an award of refunds is compelled by the agency’s governing statute, courts of appeals generally have not imposed a presumption in favor of refunds. See *Towns of Concord*, 955 F.2d at 75 (D.C. Cir. 1992)(“[A]bsent some conflict with the explicit requirements or core purposes of a statute, we have refused to constrain agency discretion by imposing a presumption in favor of refunds”).

Furthermore, a refund presumption is particularly disfavored where an agency has affirmatively approved or prescribed a rate but the rate order has been remanded by the court of appeals. The principle applicable to such refund decisions was enunciated by the Supreme Court in *Atlantic Coast Line R.R. v. Florida*, 295 U.S. 301 (1935). Because a refund in these circumstances is akin to a restitution action, “a remedy which is equitable in origin and function,” to justify a refund it is necessary to establish:

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<sup>4</sup> *Exxon Co. v. FERC*, 182 F.3d 30, 49 (D.C. Cir. 1999) (“Refunds are not mandatory; the Commission has the discretion to decide whether a refund is warranted in light of the interests of the customer and the utility.”) (quoting *Second Taxing Dist. Of the City of Norwalk v. FERC*, 683 F.2d 477, 490 (D.C. Cir. 1982)); *Koch; Towns of Concord, Norwood, and Wellesley, Mass. v. FERC*, 955 F.2d 67 (D.C. Cir. 1992); *Public Service Commission of West Virginia v. Economic Regulatory Administration*, 777 F.2d 31, 35 (D.C. Cir. 1985); *Moss v. Civil Aeronautics Board*, 521 F. 2d 298 (D.C. Cir. 1975), *cert. denied*, 424 U.S. 966 (1976).

that the money was received in such circumstances that the possessor will give offense to equity and good conscience if permitted to retain it.

*Id.* at 309. The courts have continued to apply the *Atlantic Coast* standard, imposing no presumption that refunds must be awarded after a court remand. *See, e.g., West Virginia*, 777 F.2d at 35 (declining to apply a “strong, albeit rebuttable, presumption in favor of refunds”). In remand cases, unlike the typical refund situation, the rates normally have been “charged by the carriers in reasonable reliance on the [agency’s] explicit approval of them.” *Moss*, 521 F.2d at 314 (D.C. Cir. 1975). Accordingly, “the consequences of [the agency’s] mistake should not be visited upon the carriers,” especially in the absence of “any actual unjust enrichment.” *Id.* at 315.

There is no bright-line test to determine whether a refund should be awarded. In the absence of unjust enrichment, agencies have been held to have abused their discretion by ordering refunds. *See, e.g., Koch*, 136 F.3d at 817 (holding that FERC should not have ordered a pipeline to pay its customers a refund since the pipeline did not receive a windfall). Even the presence of unjust enrichment, however, does not dictate that refunds be awarded. In evaluating the appropriateness of a refund, the Commission is required to look at the particular facts of the case to determine what is fair. An agency’s decision must represent a “reasonable accommodation of the relevant factors” and the court must be satisfied that the remedy is “equitable under the circumstances.” *Koch* at 816 (*quoting Laclede Gas Co. v. FERC*, 997 F.2d 936, 944 (D.C. Cir. 1993)). In all cases, an agency must carefully consider equitable factors prior to ordering a refund.

As the legal recipients of compensation payments at the rate prescribed by the Commission, the PSPs in this proceeding stand in the same shoes as the carriers in the cases discussed above, and have the same equitable rights to retain payments legally collected under prescribed rates, unless they are shown to have been unjustly enriched by those compensation payments.

## II. THE EQUITIES IN THIS CASE PRECLUDE ANY AWARD OF REFUNDS FOR THE INTERMEDIATE PERIOD

Applying the equitable principles of these cases to the situation in this proceeding leaves no doubt that the Commission cannot fairly require independent PSPs to refund compensation that they legally collected from IXCs during the Intermediate Period.



In *Moss*, the D.C. Circuit federal court of appeals discussed in exhaustive detail the equitable standards and considerations applicable to a request for post-remand refunds of airline passenger fares involving hundreds of millions of dollars.<sup>5</sup> The court previously had invalidated certain fares that were determined in violation of statutory procedures and ratemaking criteria. Petitioners sought refunds of the difference between the unlawfully adopted rates and the rates that would have resulted from retroactive application of the ratemaking standards subsequently adopted.

Stating that “the Board correctly focused on the equity of restitution and not just the reasonableness of past rates” (*Id.*, 521 F.2d at 308), the Court noted that a variety of equitable considerations could justify denial of refunds even where fares exceeded what was just and reasonable. Such considerations included: (1) the absence of actual profits; (2) the impossibility of reimbursing those who actually paid the illegal rates; and (3) the adverse impact of a refund on the health of the industry involved, especially if the industry has experienced a “ruinous decline” in traffic volumes. *Id.*

These factors are all present and apply with even greater force to the instant matter of payphone compensation refunds. Unlike the rate in *Moss*, which was prescribed in violation of statutory procedures and criteria, in this case the \$.284 rate at issue was legally prescribed under the statute but was remanded for a clearer explanation of the ratemaking rationale. Like *Moss*, the equitable factors relevant to this case clearly compel the conclusion that no refund is warranted for compensation legally collected by PSPs during the Intermediate Period.

#### A. Absence of Excessive Profits

One of the key factors considered in *Moss* and other cases in deciding whether to grant post-remand refunds is whether the service providers *actually earned* excessive profits during the relevant period. In *Moss* the court stressed that “during the period in which the October 1, 1969, rates were charged, the airlines did not in fact earn excessive profits from their passenger operations.” *Moss* at 302. Similarly, the PSPs have not earned “excessive profits” from the \$.284 rate charged in the Intermediate Period.

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<sup>5</sup> Just one relatively minor aspect of the invalidated rate increase, which allowed the airlines to round up fares to the nearest dollar, yielded some \$50 million in additional revenue, which is more than the total amount of approximately \$35 million at stake for the independent PSPs for the Intermediate Period.

1. IPSPs Did Not Recover, on Average, Even the Minimum Recovery Found Necessary by the Commission for a Marginal Payphone, Much Less Realize Any Unjust Enrichment

As APCC has shown, even at the \$.284 rate, independent PSPs did not, in fact, earn the amount of dial-around compensation revenues that the FCC found would be necessary to recover the costs of payphones installed at marginal locations. See Letter from Albert H. Kramer to Dorothy Attwood, March 26, 2001, at 5 (“*APCC March 26, 2001 Ex Parte*”), Attachment 1 hereto (showing that independent PSPs’ marginal payphones collected an estimated \$27.55 per payphone per month in 1998, more than six dollars below the level of compensation required for marginal payphones to break even under the Commission’s own cost analysis supporting the \$.24 rate).

In evaluating whether excessive profits were earned, the court of appeals in *Moss* recognized (as did the Board) that ratemaking standards applied to the prospective determination of “just and reasonable rates” do not automatically apply to retroactive determinations in which the standard is unjust enrichment. *Id.* at 308. In *Moss*, for example, the Board found that the actual “load factors” (estimated percentage of airplane seats filled) experienced during the period for which refunds were claimed were substantially lower than the load factors adopted prospectively. *Id.* at 309. The Board also declined to apply retroactively its prospective ratemaking policy that disallowed any allowance for dilution of revenues due to discount fares. The Court agreed that it would be inequitable to apply retroactively a policy designed to influence prospective behavior (by discouraging discount fares), especially “when inadequate profits were made by the carriers even under the constraints then applicable.” *Id.* at 312.

Similarly, with respect to cost recovery the PSPs have experienced problems analogous to those that prevented the airlines from earning a reasonable rate of return. Just as the airlines’ traffic volumes were lower than the prospective rates assumed, APCC has shown that the actual call volumes per payphone for which compensation was collected during the Intermediate Period are far lower than the estimated call volumes on which the \$.238 rate was based. Moreover, these lower collections resulted primarily from PSPs inability to identify and effectively collect compensation from resellers.<sup>6</sup> In the *Third Payphone Order* the Commission prospectively excluded any allowance for uncollectable compensation in its cost-based rate of \$.24 per call, because at that time there was insufficient experience

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<sup>6</sup> Another factor in the low level of compensated call volumes, which was equally beyond PSPs’ control, was the failure of LECs and IXC to timely implement the payphone coding digit identifiers ordered by the Commission.

with uncollectables in a per-call system. At the same time, however, the Commission acknowledged that there could be a defect in the compensation scheme causing massive shortfalls in collections. Prospectively, the Commission found that uncollectables “would be significantly reduced” if the Commission acted favorably on the pending issue of who pays for reseller calls.<sup>7</sup> But the issue of how to address uncollected compensation retroactively was left open. Indeed, in the *Third Payphone Order* the Commission expressly recognized that equity required it to consider uncollectables in its planned retroactive true-up for the Interim Period. *Id.*, ¶ 162.

Consideration of uncollectables is equally relevant to the equity of requiring refunds for the Intermediate Period. Whatever the merits of disallowing uncollectables on a prospective basis, it is clearly inappropriate to apply the same rate retroactively in light of the current record. Remedying the insufficiency of evidence that the Commission was concerned about in the *Third Payphone Order*, APCC has demonstrated that massive amounts of uncollected compensation for the relevant period have resulted from now-recognized defects in the compensation scheme. See *APCC March 26, 2001 Ex Parte* at 5-6, Attachment 1, hereto.

2. Any Overcompensation of Independent PSPs Is Far  
Outweighed by the Undercompensation of Independent  
PSPs in the Early Period

Even if the Commission were to find that independent PSP revenues exceeded costs during the Intermediate Period, which, as we have shown, they did not, the determination of whether the Commission’s error necessitates corrective action to redress “unjust enrichment” must consider whether any excess profits of independent PSPs in the Intermediate Period were offset by the massive undercompensation of independent PSPs in related periods as a result of *other* FCC errors of law. The record shows that independent PSPs were grossly undercompensated in the Early Period (June 1, 1992 – November 6, 1996).<sup>8</sup>

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<sup>7</sup> *Id.*, ¶ 162. The Commission did, subsequent to the Intermediate Period in question here, act prospectively to resolve the problem of collecting from resellers, by shifting payment responsibility to the first facilities-based IXC. *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Second Order on Reconsideration*, 16 FCC Rcd 8098 (2001) *petition for review pending, Sprint v. FCC*, (D.C. Cir. No. 01-1266, filed June 12, 2001). Thus, the Commission’s prospective “fix” came too late to assist PSPs during the Intermediate Period..

<sup>8</sup> Independent PSPs also were undercompensated for the Interim Period (November 7, 1996 – October 6, 1997). See *Early Period Ex Parte*, Attachment 2.

While service providers may not be entitled as a matter of *law* to recoup past losses in *prospective* rates, the question of *equity* posed by *retroactive* application of post-remand rates presents different considerations. In the real world, a firm's profitability and economic health depends on its performance over time, not on whether profits were earned in each period taken in isolation. APCC has shown that due to additional errors of law on the part of the FCC, PSPs did not come close to collecting the FCC-defined cost-based compensation in the Early Period. *Id.* If the Commission intends to take retroactive action to correct mistakes, it must consider globally all its mistakes affecting related periods of payphone compensation. The massive undercompensation suffered by PSPs in these periods must be offset against any excess profits attributed to independent PSPs.

In sum, ordering independent PSPs to refund IXC's compensation for the Intermediate Period would be inconsistent with case precedent and with the governing statutory provision. As the court observed in the decision that gave rise to this remand proceeding, Section 276(b)(1) of the Act provides the FCC with "the authority to order refunds *where overcompensation has occurred*," i.e., "where doing so is necessary to ensure fair compensation." *MCI*, 143 F.3d at 609. As discussed above, independent PSPs were in fact grossly undercompensated in the Early, Interim, and Intermediate Periods. Thus, to order independent PSPs to refund IXC's would be inconsistent with Section 276(b)(1) of the Act which requires the Commission to ensure fair compensation to payphone providers. 47 U.S.C. § 276(b)(1).

**B. The IXCs Have Already Recovered Their Payments – The End Users That Actually Paid the Higher Rates Will Not Receive Refunds**

Another factor considered in *Moss* was that "it may be impossible to reimburse those who actually paid the illegal rates." *Id.*, 521 F.2d at 308. Here, it is similarly impossible to reimburse the ultimate ratepayers. IXCs have already recovered the Intermediate Period compensation from their customers, and would be the recipients of a massive windfall if they were paid a refund by independent PSPs. See CPA Petition, Exhibit 2.<sup>9</sup> There is no reason to believe that the IXCs will pass a refund on to their customers – and there is certainly no way to provide a refund to those customers who actually paid for the payphone calls made during the Intermediate Period.

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<sup>9</sup> Exhibit 2 of the CPA Petition and relevant text from the CPA Petition are appended as Attachment 2 hereto for the convenience of the Commission.

Moreover, requiring independent PSPs to refund IXC's would unjustly enrich IXC's even if one assumed that IXC's had paid independent PSPs an amount greater than independent PSPs' cost of originating dial around calls. This is because IXC's pass on the cost of dial around compensation to their customers. Thus, further recovery would mean that IXC's would be recovering their costs more than three times: (1) in the initial recovery from end users, who would not get back any of the payphone surcharges they paid, (2) in various payphone-related cost savings, including the "free ride" the IXC's experienced by avoiding payment for the majority of dial around calls for a 4 year period,<sup>10</sup> and (3) in the recovery from PSPs pursuant to the retroactive refund.<sup>11</sup>

IXC's have passed on or otherwise recovered their cost of dial around compensation in several ways. First, IXC's assess millions of dollars in surcharges on payphone calls. In the Intermediate Period, some major IXC's assessed surcharges of up to 35 cents per call. See CPA Petition, Exhibit 2 at 1, Attachment 2, hereto (attachment to letter from Marie Breslin to Magalie Roman Salas, March 11, 1998). Prepaid card providers frequently assessed even higher surcharges. Thus, the amount of the surcharges exceeded the \$.24 compensation rate. In addition to the surcharges, IXC's raised their rates for subscriber 800, business long distance, and calling card calls, explicitly to compensate PSPs. In 1997, AT&T alone generated some \$640 million dollars from its rate increases. *Id.*

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<sup>10</sup> See Letter of April 15, 2002 to William F. Caton, Acting Secretary, FCC, from Albert H. Kramer and Robert F. Aldrich re Early Period (1992-1996) Compensation ("Early Period Ex Parte").

<sup>11</sup> The Commission may be concerned about whether individual IXC's may have overcompensated independent PSPs in the Intermediate Period, even though the total compensation collected in that period did not unjustly enrich PSPs. In light of the IXC's' demonstrated recovery and over-recovery of their compensation payments, the Commission need not be troubled by such overpayment concerns. Further, the Commission is not required to balance the books of every IXC who paid compensation in the Intermediate Period. The Commission is only required to address equity for IXC's collectively. In *Moss* the court did not examine whether individual passengers paid unreasonable fares for their flights, and the Commission likewise is not compelled to address whether each individual IXC overcompensated PSPs. In other words, an analysis at the industry level of whether a refund is appropriate is sufficient.

Notwithstanding these considerations, to address any lingering concerns about overpayment, APCC intends shortly to submit data that it believes will show that, when all relevant compensation periods are taken into account, each of the major IXC's paid less than its share of the compensation needed for full cost recovery by independent PSPs.

At the same time that IXC's were overcompensated by their customers for their dial-around payments through the surcharges and rate increases, IXC's saved \$250 million per year from the elimination of interstate subsidies for payphone services provided by local phone companies. *Id.* Significant additional subsidies were also terminated at the state level. *See* CPA Petition (Attachment 2 hereto), Exhibit 3 at 17 (attachment to letter from Albert H. Kramer to Magalie Roman Salas, March 16, 1998). The IXC's have also saved a significant amount of money from the reduction in commission payments to PSP's due to the shift away from commissionable 0+ calls. In 1997 alone, IXC's saved some \$370 million from this shift. *See* CPA Petition (Attachment 2, hereto), Exhibit 2 at 1 (attachment to RBOC Coalition *ex parte* letter from Marie Breslin to Magalie Roman Salas (March 11, 1998)).

Accordingly, not only have IXC's over recovered for their dial around costs from their customers through surcharges and rate increases, IXC's have also failed to pass on to their payphone customers any portion of their cost savings from the payphone-related reduction in access charges and the reduction in commissionable 0+ calls. In light of this, requiring PSP's to pay retroactive compensation to IXC's would provide IXC's with a significant windfall. There is no reason to believe that IXC's would pass through to payphone callers the refunds awarded by the Commission, and in any event, it would be "impossible to reimburse those who actually paid" the payphone surcharges in the Intermediate Period. *Moss*, 521 F.2d at 308.

**C. The Payphone Industry Would Be Economically Endangered By Mass Refunds**

Another factor considered in *Moss* was the need to preserve the health of the airline industry, especially if that industry has already suffered a "ruinous decline" in traffic volume:

Even if excessive profits were made in a given period, there may be inequity in trying to recover them. . . . The bite which is effectively taken from future earnings by a recovery fund may in turn impair the health of the industry, to the disadvantage of the fare-payers themselves. . . . The excessive profits sought to be recovered were not in fact earned but must be hypothesized by a recomputation of costs and revenues. A substantial fare-payer recovery on this theory would in practical effect mean that an airline industry which had performed badly in the past (from the investors point of view) would be all the more likely to perform badly in the future. The equitable aspects of

refunding past rates are as inextricably entwined with the Board's normal regulatory responsibility, as such refunds may substantially affect the future rates, performance, and health of the industry.

*Id.* at 308.

Just as the statutory objectives governing the Civil Aeronautics Board guided the analysis of equities in *Moss*, the Commission's statutory responsibility to "promote . . . widespread deployment of payphones to the benefit of the general public" must guide its equitable determinations here. 47 U.S.C. § 276(b). The Commission's foremost duty is to "ensure that payphone service providers are fairly compensated" in order that payphone deployment may be promoted by federal compensation policy. *Id.*, § 276(b)(1)(A). At a minimum, the Commission must "do no harm": its exercise of discretion regarding compensation refunds must not suppress payphone deployment or impair the health and performance of the payphone industry.

Today, the danger to payphone deployment that would result from a refund of Intermediate Period compensation is at least as serious as the danger to the airline industry with which the court was concerned in *Moss*. As the Commission is well aware, the sharp and steady annual increases in wireless phone use have caused a debilitating decline in payphone call volumes and payphone industry profits. As FCC statistics show, the result has been a significant decline in payphone deployment since 1999. See FCC Common Carrier Bureau, Industry Analysis Division, *Trends in Telephone Service*, August 2001, Table 8.5 (showing that the total number of payphones in the United States declined from 2,121,526 in March 1999 to 1,919,640 in March 2001). In community after community, these statistics translate into the removal of payphones from locations where there is still a significant need for service. See Attachment 3. And as the events of September 11, 2001 demonstrated, the need for payphones is greatest in emergencies. At such times it is critical for payphones to be available to provide a lifeline for distressed citizens.

The contemplated refund of Intermediate Period compensation would total about \$33 million for PSPs for whom APCC collects payphone compensation – which is roughly equal to those PSPs' total compensation payment for three months. There can be little doubt that a refund of a full quarter's dial-around compensation would significantly "impair the health of the industry" and the continuing deployment of payphones to meet the needs of the public.

**D. Refunds Will Cause an Administrative Nightmare and Unfairly Force PSPs to Bear the Burden of Errors**


Finally, the Commission should not order a true-up for independent PSPs given the administrative complexity of implementing such an order and given that the nature of the compensation process will force independent PSPs to bear the burden of correcting errors, absent preventive Commission action. There are more than a hundred IXC's and thousands of independent PSPs involved in Intermediate Period compensation; an unknown but substantial percentage of these IXC's and PSPs are no longer operating. Furthermore, with payphones continually changing hands, merely determining who currently has responsibility to provide each refund would cause an administrative nightmare.

Due to the nature of the compensation process, these problems will penalize PSPs far more than IXC's. In the compensation process, IXC's hold the money. Absent FCC intervention, therefore, any IXC that thinks a given PSP is responsible for a given refund will simply deduct that amount from the PSP's future compensation payments. The PSP's only recourse is litigation. PSPs have absolutely no leverage in this process. They cannot even cut off service to IXC's that refuse to pay, because Section 226 prohibits blocking of access code calls.

**CONCLUSION**

In summary, the Commission may not conclude that refunds of intermediate compensation are appropriate simply because the current rate is lower than the rate established in the *Second Report and Order*. The Commission must weigh all relevant equitable considerations to reach a decision that is fair under the circumstances. Here, fairness precludes requiring independent PSPs to pay a refund to IXC's for the Intermediate Period.

Sincerely,

  
Albert H. Kramer  
Robert F. Aldrich